CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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Mr. Blaine D. Stockton
Assistant Administrator
Electric Program
United States Department of Agriculture
Rural Utilities Service
Room 5156 South Building, Stop 1560
1400 Independence Avenue, S.W.
Washington, D.C. 20250-1560

Re: Comments on the Proposed Rule: *Guarantees for Bonds and Notes Issued for Electrification or Telephone Purposes*

Dear Mr. Stockton:

These comments are being filed on behalf of the U.S. Chamber of Commerce (Chamber), the world's largest business federation, representing more than three million businesses of every size, sector, and region. The Chamber serves as the principal voice of the American business community, and more than 96 percent of its members are categorized as small businesses.

The Chamber's members will be significantly affected by the Rural Utilities Service (RUS) Proposed Rule: *Guarantees for Bonds and Notes Issued for Electrification or Telephone Purposes*[1]. This is because the proposed rule contemplates creation of a regulatory structure that utilizes the *full faith and credit of the United States* to support the financial operations of *a bank or other lending institution organized as a private, not-for-profit cooperative association or otherwise on a non-profit basis*[2], ("private, not-for profit lenders") which could be inclusive of unregulated private lenders as well as other private banking entities, by extending below-market financing to them, thereby allowing them to heavily subsidize rural electric cooperatives (co-ops) and telephone companies. These unprecedented actions will give the co-ops and rural telephone companies an unfair competitive advantage over private businesses and industries in the marketplace.

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[1] 68 *Fed. Reg.*, 75153–75160 (December 30, 2003).
[2] *Ibid*, page 75155.

Although the Chamber recognizes that Congress, as a rider to the 2002 Farm Bill[3], directed the Secretary of Agriculture to put the *full faith and credit of the United States* government behind notes and bonds issued to co-ops by unregulated, private, and other not-for-profit lenders, Congress did not exempt the RUS from compliance with the numerous regulatory requirements (cost-benefit analysis, energy impact statement, and environmental impact statements, as well as statements regarding their impact on small businesses and other small entities) that agencies must comply with when promulgating a significant regulatory action. Due to an unprecedented federal action that has the federal government guaranteeing the debts of unregulated, private, not-for-profit lenders, these impacts must be clearly stated given that Congress intends for taxpayers to ultimately cover the financial losses of these private, not-for-profit lenders when they arise.

Notwithstanding our concerns over putting the *full faith and credit of the United States* behind a private entity, it is the law of the land and the RUS must implement it. Moreover, it must be implemented in accordance with all existing regulatory requirements, since Congress did not exempt it from all laws, and the regulations must include safeguards that protect taxpayers from poor banking practices.

ISSUE BACKGROUND AND HISTORY

In 2002, Senator Harkin (D-IA) inserted a provision into the 2002 Farm Bill that requires the Secretary of Agriculture to guarantee, on the *full faith and credit of the United States*, the repayment of the principal and interest on bonds and notes issued by private, not-for-profit lenders to so-called rural electric co-ops and telephone borrowers. This provision was subsequently included in the final 2002 Farm Bill. Under the provision, certain private, not-for-profit lenders will be eligible for billions of dollars in federal government guarantees if the proceeds of the loans are used for electrification or telephone projects. One or more of these private, not-for-profit lenders has extended billions of dollars in loans and is subject to significant defaults, and by honoring the guarantees the loss will fall squarely on the American taxpayer.

ADVERSE IMPACTS OF U.S. GOVERNMENT GUARANTEES OF PRIVATE CO-OP DEBT

RUS published its proposed regulation in the *Federal Register*[4] as a first step toward implementing the guarantee program. Overall, the regulation is poorly drafted, contains numerous fatal flaws, and does not protect federal taxpayers from losses. The flaws include: a failure in the regulation to require that the guarantee be fully collateralized throughout the life of guarantee; not requiring that "investment-grade quality" loans be used by these private co-op's for collateral; and not requiring that these private, not-for-profit lenders be subject to annual examinations by a qualified bank regulator, such as the Office of the Controller of the Currency, or the Federal Deposit Insurance Corporation.

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[3] P.L. 107-171, Title VI, Subtitle B., § 1601(a), 116 Stat. 413.
[4] *Ibid.*

In addition, RUS does not have the competence or "independence" to assess the co-op's loan guarantee applications; the financial condition of the private, not-for-profit lenders; and most importantly, the RUS does not have the capability to assess the loan loss risk, an assessment that is essential to protect taxpayers against losses. This is of particular concern because RUS has never overseen a private bank with a portfolio containing tens of billions of dollars and is largely uninformed about such matters. To illustrate our point, the RUS has failed to assess risk in power supply lending, incurring an overall default rate of more than 20 percent, and it has lost many key, experienced, and competent staff, leaving it vulnerable to making risky loans and loan guarantees.

Such a guarantee will result in major adverse competitive impacts. Recipient electric and telephone borrowers serve huge geographic areas in 38 states and pose a major competitive threat to the electric and telecommunication companies. In addition, the co-ops are diversifying into other businesses, including propane, home security, appliance sales and service, heating and air conditioning, and the Internet, among other business activities. All of these additional businesses will be subsidized by the taxpayer, and as such will create unfair competition with private sector companies.

These loan guarantees will lower the borrowing costs for these co-ops to rates near those offered by the United States Department of the Treasury, and will eliminate loan losses, resulting in its borrowers receiving major competitive advantages nationwide. Private sector, federal tax paying businesses in rural and metropolitan areas will be at a competitive disadvantage against these heavily subsidized co-ops. Note that electric co-ops operate in 25 of the 32 major metropolitan areas with populations in excess of one million people.

BAD POLICY

The impact of RUS providing guarantees on loans made by a private, not-for-profit lender to a co-op is that the private, not-for-profit lender effectively becomes "RUS II," without traditional federal agency controls. There are no federal regulations to govern lending; no Office of Management and Budget (OMB) compliance requirements; management is independent and not accountable to the Secretary of Agriculture, the President, and Congress; there is no federal oversight by a regulator, such as the FDIC; and billions of United States government dollars are at risk. This is an unprecedented expansion of federal lending in private capital markets.

RUS covers all losses on loans to co-op electric and telephone borrowers. For electric loans, more than $13 billion has been lost since 1985. Electric and telephone borrowers get grants from the Federal Emergency Management Agency to cover at least 75 percent of any losses from storm damage. Further, they get economic development grants from RUS that

are used to attract businesses from non-subsidized utility service areas to cooperative service areas. Overall, for electric co-ops these subsidies exceed 2¢ per kWh of the average retail rate of 6.7¢ kWh, and they are able to purchase low cost (1.2¢ per kWh) electric power from federal hydroelectric projects.

REGULATORY DEFICIENCIES

Notwithstanding the provisions of the 2002 Farm Bill, RUS must still comply with all regulations and executive orders for issuing regulations. In this regard, RUS's proposed rule also has a number of procedural defects that require reanalysis and that prevent its final promulgation.

RUS'S PROPOSED RULE FAILS TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT

RUS's proposed rule does not appear compliant with the Regulatory Flexibility Act[5]. The Regulatory Flexibility Act requires federal agencies to assess the likely impacts of their regulatory proposals on small businesses and other small entities, and to consider alternatives that are less burdensome. In particular, RUS is required to prepare an initial regulatory flexibility analysis (IRFA) of the proposed rule's economic impact on small entities[6].

The IRFA must include a description of why the proposed action is being considered, the objectives of and legal basis for the proposed rule, a description and estimate of the small entities that will be impacted by the proposed rule, projected reporting, record-keeping, and other compliance requirements, as well as an identification of other federal rules that may duplicate, overlap, or conflict with the proposed rule[7]. Additionally, the IRFA must include a description of significant alternatives the agency has considered that might accomplish the objectives of the rule in a less burdensome way to small entities[8]. The analysis (or a summary of it) must be published in the *Federal Register* along with the proposed rule and transmitted to the Office of Advocacy of the United States Small Business Administration for review[9].

The requirements for preparation of an IRFA may be waived if the head of the agency "certifies" that the proposed rule will not, if promulgated, have *a significant economic impact on a substantial number of small entities*[10]. The Office of Advocacy of the United States Small Business Administration has issued guidance to federal agencies (Advocacy

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[5] 5 U.S.C. §601 et seq.
[6] 5 U.S.C. §603(a).
[7] 5 U.S.C. §603(b).
[8] 5 U.S.C. §603(c).
[9] *Ibid,* Footnote 4.
[10] 5 U.S.C. §605(b).

Guidance)[11], which instructs agencies about how to prepare an IRFA and how to make a proper "certification" of "no significant impact" on small entities. The RUS proposed rule fails to meet these requirements in several important respects.

First, RUS's proposed rule states that the agency has "determined" that the proposed regulation *will not have a significant impact on a substantial number of small entities.* However, both the Regulatory Flexibility Act and the Advocacy Guidance make clear that the head of the agency must "certify" (not "determine") that this statement is correct. It is not evident that RUS has made such a certification. Second, Advocacy Guidance makes clear that prior to certifying, the Agency must undertake a detailed analysis that fully assesses any likely impacts on small entities[12]. It does not appear that RUS has undertaken such a requisite analysis. Third, even if the requisite analysis was completed, the statement contained in the proposed rule is deficient under the Advocacy Guidance[13]. That guidance makes clear that the agency must fully disclose the basis for its certification, including an examination of the entities potentially impacted, the disclosure of all assumptions, and range of uncertainties[14]. No such information is included in the RUS *Federal Register* notice.

Additionally, there is no indication that RUS forwarded the certification to the Office of Advocacy in advance of its publication as required by the guidance[15]. In fact, the RUS notice provides no analysis whatsoever on how it determined that no small entities will be impacted. This is a particular concern since the statute contains no criteria that would directly exclude participation by small entities[16]. Rather, the statute simply allows RUS to deny loan guarantee requests if the lender does not have appropriate expertise, or the lender is not issuing investment-grade quality loans. Furthermore, this determination greatly underestimates the impact of this regulation on the increased availability of low-interest loans. These loans will affect competition in the energy markets throughout rural America and invariably will affect every small business located in those areas, in particular when the loans are made to entities competing against private sector entities that for example sell propane, home security, appliances, heating and cooling services, and Internet services.

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[11] *The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies*, Office of Advocacy of the United States Small Business Administration, November 2002.
[12] *Ibid*, page 22.
[13] *Ibid.*
[14] *Ibid*, page 27.
[15] *Ibid*, page 22.
[16] 7 USC §940c-1.

RUS'S PROPOSED RULE FAILS TO ADEQUATELY ADDRESS ITS REVIEW UNDER NEPA

In addition to its failure to comply with the Regulatory Flexibility Act, the RUS proposed rule fails to comply with the National Environmental Policy Act (NEPA), which requires all federal agencies to review the environmental impact of any major federal action that significantly affects the quality of the human environment[17]. The proposed rule's description of this review is not sufficiently transparent. RUS has determined that the proposed rule will not significantly affect the quality of the human environment as defined by NEPA and that an EIS is not required. However, the proposed rule fails to discuss what review was undertaken, and no Finding of No Significant Impact (FONSI) has been made available and distributed to the public, as required by NEPA[18].

RUS is under a clear regulatory requirement by its own NEPA implementation regulations to conduct an environmental review prior to final action, including whenever the agency issues new or revised rules, regulations, and bulletins[19]. By failing to fully address its FONSI in a public manner, it is impossible to evaluate what "economic considerations" and "socioeconomic concerns" RUS reviewed[20]. RUS is mandated to *make diligent efforts to involve the public in the environmental review process*[21]. In light of this clear regulatory requirement, RUS's NEPA determination warrants reconsideration, greater public involvement, and considerably more transparency.

RUS HAS FAILED TO PROVIDE A STATEMENT OF ENERGY EFFECTS

RUS has failed to adequately assess the effects of the proposed rule on energy markets. Executive Order 13211, *Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use*, requires RUS to prepare a Statement of Energy Effects (Statement) when it undertakes a significant regulatory action. The Statement must include details on *any adverse effects on energy supply, distribution, or use*, as well as details on the reasonable *alternatives to the action*, and the expected effects of such alternatives on energy, supply, distribution, and use. Since loans made by an unregulated private lender may most likely be for energy transmission and distribution, it is reasonable to believe that an energy impact statement is required. The proposed rule fails to include this Statement. Without it, it is impossible for the public to ascertain what *reasonable alternatives to the action* RUS considered and how it expects those alternatives to affect *energy supply, distribution, and use* in rural areas.

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[17] 42 USC §4321 et seq.
[18] 40 CFR 1508.9.
[19] 7 CFR §1794.3
[20] 7 CFR §1794.12
[21] 7 CFR §1794.13

THE RUS PROPOSED RULE FAILS TO COMPLY WITH EXECUTIVE ORDER 12866

Under Executive Order 12866, Regulatory Planning and Review (E.O. 12866), all "significant regulatory actions" by federal agencies must undergo cost-benefit assessment by the agency and centralized review by OMB's Office of Information and Regulatory Affairs (OIRA). Under these provisions, the agency must provide OIRA with a copy of the draft text of the proposed regulation and an assessment of the costs and benefits of the regulatory action prior to its publication[22]. In addition, for proposed rules that are deemed to be "economically significant" (i.e., having an annual economic impact of more than $100 million), a far more detailed and rigorous regulatory impact assessment is required[23].

Although RUS has determined that the proposed rule is a "significant regulatory action" under E.O. 12866, it has indicated that it is not an "economically significant" rule. However, the agency's own economic analysis shows that to date there have been defaults in excess of $4.5 billion under programs managed by the RUS, clearly far surpassing the $100 million economic impact threshold. This notwithstanding, the proposed rule utterly fails to explain, in any manner, how a program with both historical and expected direct costs of billions of dollars is not economically significant. For this reason, both RUS and OIRA should re-evaluate the economic impact of the proposed rule and provide a meaningful explanation for its determination. This cost-benefit assessment will also have to consider all the financial implications of the regulation, such as the failure to require the guarantee to be fully collateralized throughout the life of the guarantee, that the loans are not subject to annual examinations by a qualified bank regulator, and the lack of experience on the part of the institutions involved in the guarantee process.

THE RUS PROPOSAL LACKS ADEQUATE OPPORTUNITY FOR PUBLIC PARTICIPATION

RUS has failed to provide an adequate opportunity for public participation during the development of this proposed rule. First, the proposed rule does not appear on the list of planned regulatory actions in the Unified Agenda of Regulatory and Deregulatory Actions (Unified Agenda)[24] as required by E.O 12866[25]. That section makes clear that *[i]n order to have an effective regulatory program,....to maximize consultation and the resolution of potential conflicts at an early stage, [and] to involve the public, and its State, local, and tribal officials in regulatory planning*[26],

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[22] E.O. 12866, Section 6(a)(B).
[23] *Ibid,* Section 6(a)(C).
[24] See, http://ciir.cs.umass.edu/ua/Fall2003/agenda/DEPARTMENT_OF_AGRICULTURE_(USDA).html.
[25] E.O 12866, Section 4(b).
[26] *Ibid,* Section 4.

[e]ach agency shall prepare an agenda of all regulations under development...[27], and forward that information to OIRA for inclusion in the Unified Agenda. Because this proposed rule does not appear in the Unified Agenda, the public did not receive advance notice of this proposed rule, nor were they given the opportunity to be involved in the planning process.

Second, E.O. 12866 makes clear that each agency has the responsibility to *provide the public with meaningful participation in the regulatory process....*[28], and *....before issuing a notice of proposed rulemaking...[shall] seek the involvement of those who are expected to benefit from and those expected to be burdened by any regulation....*[29] We are aware of no such opportunity for pre-publication notice having been afforded to interested members of the public in this instance.

Third, E.O. 12866 states that *[a]fter the regulatory action has been published in the Federal Register....the agency shall make available to the public [the assessment of the potential costs and benefits of the regulatory action], the substantive changes between the draft submitted to OIRA for review and the action subsequently taken*[30]. However, no such information has been included in the preamble of the proposed rule, nor has it been posted on the agency's website. Without this disclosure, the public is unable to assess the economic impact of the proposed regulation, to determine whether the proposed rule is economically significant, or to evaluate the interaction that took place with OIRA.

Finally, we note that the RUS website contains virtually no information concerning this proposed rule except for a link to the *Federal Register* notice[31]. We note that the President's E-Government Initiative seeks to mandate, among other things, that federal agencies make all of their rulemaking dockets electronically available to the public[32]. This information is vital to ensuring the transparency of the regulatory process and ensuring meaningful public participation in the rulemaking process. It does not appear that RUS has made any attempt whatsoever to establish an electronic docket for this proposed rule.

THE PROPOSED RULE FAILS TO DEFINE ITS KEY TERMS

Finally, the rule proposed by RUS fails to set forth necessary definitions of its scope. For example, 7 USC §940c-1(b)(2) clearly limits the jurisdiction of RUS by preventing issuance of a loan guarantee, the proceeds of which will be used for the *generation of electricity*. However, neither 7 USC §940c-1 nor RUS's underlying statutory authority adequately define what generation of electricity means. In the absence of any definition describing the external boundaries and limits within the power grid structure of what the

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[27] *Ibid,* Section 4(b).
[28] *Ibid,* Section 6(a).
[29] *Ibid.*
[30] *Ibid,* Section 6(a)(E)(i) and (ii).
[31] See, http://www.usda.gov/rus/electric/regs/fedreg.htm.
[32] See, www.whitehouse.gov/omb/memoranda/m01-18.pdf).

generation facility might be, RUS's failure to propose a definition is fatal. Absent an adequate definition of generation of electricity, neither RUS nor the public can adequately determine the extent of RUS's jurisdiction and therefore whether RUS has legal authority to make the loan guarantees. RUS must clearly define these terms so that the public knows the limits of RUS's authority and that if RUS exceeds its authority it can be challenged in court.

Furthermore, under the 2002 Farm Bill[33] from which this regulation and its underlying statutory authority arose, there was a concerted effort to add provisions to expand broadband and telecommunication infrastructure to rural areas. 7 USC §940c-1 applies to both rural electrification and rural telephone infrastructure improvements, yet, RUS fails to adequately define what is and is not an adequate telephone purpose. Further, in light of the intent of Congress that a significant portion of the loan guarantees go toward improving rural telecommunications capability, it is troubling that RUS does not indicate to what extent the loan guarantees will be apportioned between rural electrification and rural telecommunication services. The Chamber urges RUS to make these determinations before final promulgation of the rule.

CONCLUSION

Taken as a whole, if this regulation proposed by RUS moves forward, RUS must conform to all the regulatory procedural requirements stated above, and any lender seeking a guarantee must, at a minimum, be required to conform to the Federal Institutions Reform, Recovery and Enforcement Act. Moreover, if the lender is unregulated, it must also be subject to annual examinations by the Office of Thrift Supervision, or the Office of the Controller of Currency or a certified public accounting firm that garners at least 30 percent of its total annual audit revenue from audits or examinations of banks.

It is also essential that an adequate reserve or bankruptcy trust fund be established at a minimum level of seven percent to protect taxpayers from losses. Co-op loans bear substantial risk, and the Chamber is strongly concerned that RUS must be able to adequately assess potential risks or prevent such loan losses. Moreover, no reserve fund can adequately protect taxpayer interests if the eligibility criteria for federal guarantees are nonexistent or weak. Such eligibility criteria should, at minimum, provide for collateralization with investment-grade quality borrower mortgages equal to the amount of the guarantee outstanding throughout the full life of the guarantee.

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[33] See Footnote 2.

The changes suggested above are absolutely necessary to minimize taxpayer losses and for RUS to comply with the standard procedural safeguards imposed on all agencies taking significant regulatory actions. That observation notwithstanding, the Chamber believes that no such set of rules can fully protect taxpayers where lending and recovery are not dictated by the discipline of the financial marketplace.

Sincerely,

William L. Kovacs